




COUNCILMEMBER DONNA FRYE

**City of San Diego
Sixth District**

MEMORANDUM

DATE: June 29, 2010

TO: Mayor Jerry Sanders
Council President Pro Tem Kevin Faulconer, Chair, Audit Committee

FROM: Councilmember Donna Frye 

SUBJECT: Risk of Audit by Internal Revenue Service on Water Bond Issuance

In the most recent water bond issuance, the following language appeared in the Preliminary Official Statement:

"Risk of Audit by Internal Revenue Service

The Internal Revenue Service (the "IRS") has an ongoing program of auditing tax-exempt obligations to determine whether, in the view of the IRS, interest on such tax-exempt obligations is includable in the gross income of the owners thereof for United States federal income tax purposes. No assurances can be given as to whether or not the IRS will commence an audit of the 2010A Bonds. If an audit is commenced, under current procedures the IRS is likely to treat the Authority as the taxpayer and the owners of the 2010A Bonds may have no right to participate in such procedure.

Bond Counsel's opinion represents its legal judgment based upon its review of existing law, regulations, rulings, judicial decisions, and other authorities, and upon the covenants and representations of the parties and such other facts as it has deemed relevant to render such opinion, and is not a guarantee of a result. Bond Counsel is not obligated to defend the tax-exempt status of the 2010A Bonds. Neither the Authority nor Bond Counsel is responsible to pay or reimburse the costs of any owner with respect to any audit or litigation relating to the 2010A Bonds."

1. Please explain what it would mean to the PFFA, the City of San Diego and the bond holders if the "interest on such tax-exempt obligations is includable of the gross income of the owners." For example, wouldn't it be more difficult to sell the bonds?
2. Given the above disclosure statement, did anyone ask the IRS for an opinion in advance of the bond offering?
3. Please provide a copy of Bond Counsel's legal opinion regarding the tax-exempt status of the 2010A Bonds.
4. What other bond offerings include the same language as shown above?

CC: Honorable City Councilmembers
Jan Goldsmith, City Attorney
Jay Goldstone, COO
Mary Lewis, CFO
Lakshmi Kommi, Director, Debt Management
Andrea Tevlin, IBA
Bond Counsel, Hawkins Delafield & Wood